

BEFORE THE
SURFACE TRANSPORTATION BOARD

Canadian National Railway Company, and
Grand Trunk Corporation

– Control –

Duluth, Missabe and Iron Range Railway Company,
Bessemer and Lake Erie Railroad Company, and
The Pittsburgh & Conneaut Dock Company

Finance Docket No. 34424

REPLY OF
THE UNITED STATES DEPARTMENT OF JUSTICE

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I. Introduction

The Department of Justice hereby replies to the submissions of other parties in this proceeding, and urges the Surface Transportation Board (“the Board”) to impose conditions on any approval of Canadian National’s acquisition of railroad assets from Great Lakes Transportation to preserve the potential competition that Canadian National’s build-out opportunities provide to Great Lakes’ customers.

Our review of the competitive effects of this merger has focused on its acquisition of the Duluth, Missabe and Iron Range Railway Company (“DMIR”).¹ In our investigation, we have reviewed the comments and requests for conditions submitted by shippers (including Cleveland-Cliffs, Inc. and Ispat Inland Inc.), other railroads (including Burlington Northern Santa Fe (BNSF) and CSX) and other parties of record. We have also consulted public sources of relevant information, interviewed other shippers and met with representatives of the merging railroads.

¹ We refer to railroads by their common names in this reply. References to the primary railroads include their subsidiary railroads.

The proposed merger would combine the only railroad that transports iron ore and taconite moving from several sites in the Mesabe Range of Minnesota to U.S. steel mills in the Great Lakes region via rail/water and all rail services (DMIR), with the potential rail competitor who can enter these markets with the shortest build-outs to the Mesabe Range sites (Canadian National).² It is likely, therefore, that this transaction would reduce competition unless approval is conditioned to preserve potential competition from pre-merger build-out opportunities.

II. Possible Build-Out Opportunities

Based on comments filed by other parties, and our own investigation, it appears that the merger could eliminate potential competition from three possible Canadian National pre-merger build-out opportunities:

The EVTAC Taconite Processing Plant at Fairlane.³ The Department of Justice relies on the comments of Cleveland-Cliffs – one of the new owners of the former EVTAC taconite pellet processing plant and iron ore mine – for a detailed description of possible pre-merger build-out opportunities at this plant.⁴ In summary, the record in this proceeding indicates that DMIR is the only railroad that currently has access to the plant’s ore/taconite loading facilities. Canadian National can provide general freight service to the plant, and its track stops only about 500 feet short of the ore/pellet loop track. With a short build-out, Canadian National could compete for the

² In this reply, we refer to “build-outs” and “build-ins” interchangeably.

³ All cities, rail stations and other geographic references in this reply are in Minnesota unless otherwise indicated.

⁴ Cleveland-Cliffs, Inc.’s Comments and Requests for Conditions (Jan. 26, 2004). Cleveland-Cliff’s description of possible build-out opportunities and routings for the EVTAC mine and plant generally conforms to our independent analysis.

movement of taconite pellets from the plant over one or both of the following routes:

- a. **The “Virginia Routing.”** Currently, Canadian National, with the agreement of BNSF, could participate in a joint move from the taconite plant at Fairlane to BNSF’s ore dock at Superior, Wisconsin on the route described by Cleveland-Cliffs at page 16 of its comments (part of which would be via existing trackage rights on DMIR track between Virginia and Emmert Junction).⁵
- b. **The “Spirit Lake Routing.”** Pre-merger, Canadian National, with the agreement of BNSF, might be able to participate in a joint move from the taconite plant southward to BNSF’s ore dock at Superior (described at pages 16 - 19 of Cleveland-Cliffs’ comments). This routing, however, would depend on a successful challenge by Canadian National to the iron ore exclusion on its existing trackage rights agreement with DMIR for the Nopeming Junction/South Itaska track.

It does not appear that any other railroad could gain access to the Fairlane plant with a relatively short build-out (BNSF appears to be the next closest railroad, with a line about ten miles away from the Fairlane plant). Consequently, this appears to be a possible “two-to-one” competitive situation (*i.e.*, the number of railroads that have access to the facilities or that appear to be best-positioned to gain access to the facility with a build-out would decrease from two to one).

The EVTAC Thunderbird North Mine. The record in this proceeding also indicates that DMIR is currently the only railroad with access to the Thunderbird North mine near Shelton Junction; but it appears that a build-out of about a mile could connect the mine to Canadian

⁵ The rail map that the parties provided at page 326 of their merger application does not show BNSF’s trackage rights on the DMIR track between the vicinity of Shelton and BNSF’s line west of Hibbing, but they subsequently confirmed the existence of these trackage rights.

National's main line. With this build-out and the build-out to the Fairlane taconite processing plant described above, it appears that Canadian National could become the second railroad with the ability to compete for the movement of iron ore from the Thunderbird North mine to the Fairlane taconite processing plant.

This also appears to be a possible "two-to-one" competitive situation, as no railroad other than Canadian National could gain access to the Thunderbird North mine with a relatively short build-out to its track. Canadian National could provide single line service between the Thunderbird North mine and the Fairlane plant with these build-outs.

The U.S. Steel Minntac Mine. Finally, the record in this proceeding indicates that DMIR is the only railroad that currently has access to the Minntac mine near Mt. Iron; but it appears that a build-out of approximately four or five miles could connect the mine to Canadian National's main line in the vicinity of Minorca Junction. With this build-out, Canadian National and BNSF might be able to provide a joint line service from the mine to BNSF's ore dock at Superior via the Virginia Route, or possibly the via the Spirit Lake Route.

Again, this appears to be a possible "two-to-one" competitive situation. The next shortest build-out possibility appears to be a fifteen mile connection to BNSF's interchange at Emmert (but since it appears that BNSF might be able to reduce construction costs on this line by using an abandoned rail line, it may be appropriate to consider this as a possible "three-to-two").

III Conditions Required to Avoid the Loss of Potential Competition

It is a settled principle of antitrust law and economics that potential entrants can constrain the ability of actual competitors to exercise market power. Consequently, mergers and other consolidations of actual entrants and potential entrants that eliminate the procompetitive effects of

potential competition can harm competition – particularly if the potential entrant is one of a relatively small number of firms with the capacity and incentive to enter the market, the market is concentrated, and high barriers to entry are likely to deter other new entrants. In appropriate circumstances, the courts have enjoined such consolidations to preserve the procompetitive benefits of potential competition. *Yamaha Motor Co., Ltd. V. Federal Trade Commission*, 657 F.2d 971 (1981), *cert. den'd* 452 U.S. 915 (1982); *see also United States v. Marine Bancorporation*, 418 U.S. 602 (1974), *Engine Specialties, Inc. V. Bombardier Ltd*, 605 F.2d 1 (1979).

Currently, one railroad (DMIR) moves all of the iron ore from the Thunderbird North mine and all of the taconite from Fairlane and Minntac, and only one railroad (Canadian National) can constrain their market power by threatening to gain access to the EVTAC and Minntac sites through relatively short build-outs or build-ins. The relevant market, therefore, is heavily concentrated (and remains so even if we consider Minntac to be a “three-to-two”), and barriers to entry, other than possible Canadian National build-outs, are formidable. The threat of potential entry by a second railroad, therefore, must be preserved to constrain the merging railroads’ market power.

The proponents of build-out conditions are not required to prove that possible build-outs will necessarily be constructed. As noted in the *Conrail* merger case, it is sufficient that the build-out appears to be feasible. *CSX Corp. – Control and Operating Leases/Agreements – Conrail Inc.*, 1998 WL 456510 at 79 (1998).

All of the build-outs discussed in this reply certainly appear to be feasible. Reference to the railroad map in Canadian National’s merger application shows that the distance from each facility to the Canadian National line is a fraction of the distance to the next closest railroad (about 500 feet

versus about 10 miles for the Fairlane taconite processing plant, about a mile versus 12 or 13 miles for the Thunderbird North mine, and about four or five miles versus about 15 miles for the Minntac mine). And, the new owners of the former EVTAC facilities have spent considerable time, effort and money in this proceeding to preserve their build-out opportunities.⁶

Moreover, even where there is arguable doubt that an apparently feasible build-out will actually be constructed, the Board should strike the balance in favor of preserving potential competition. If a build-out that now appears to be feasible nonetheless proves infeasible later, the Board's preservation of that build-out opportunity imposes few if any costs.⁷

The Board, therefore, should preserve the current competitive discipline arising from Canadian National's presence as a potential entrant with rail lines a short distance away from the Thunderbird North mine, the Fairlane taconite plant and the Minntac mine by adopting conditions that put a replacement railroad in the same position as Canadian National before the merger. Those conditions should: (a) give a replacement railroad trackage rights over Canadian National's line from the vicinity of Minorca Junction to its connection with DMIR near Nopeming Junction; and (b) authorize it to connect that line to the Mesabe Range facilities through build-outs or build-ins.

⁶ No negative inference should be drawn from U.S. Steel's silence, as we understand that it is contractually prohibited from publicly advocating build-out conditions for its Minntac facility.

⁷ Likewise, if the Board gives a replacement railroad trackage rights over the Canadian National line from the Mesabe Range facilities to Nopeming Junction, and the opportunity to challenge the iron ore exclusion on DMIR's Nopeming Junction/South Itaska line, but that legal challenge is unsuccessful, it is unlikely that the condition will impose substantial costs on the merging parties. But, if the challenge is successful, and the new railroad (in conjunction with BNSF) is able to move iron ore and taconite from the Mesabe Range facilities to BNSF's docks at Superior, the benefits of preserving potential competition will almost certainly exceed whatever little costs might conceivably occur.

We leave the precise details of these trackage rights and build-out conditions to the Board (including the determination of whether the settlement agreement that we understand Cleveland-Cliffs has reached with the merging railroads adequately preserves potential competition and satisfies all other applicable public interest standards). We reiterate that the trackage rights fees to be paid by a replacement railroad should be set in a way that allows it to compete with the same marginal costs as the merged-out railroad. Otherwise, the Board's grant of build-out rights might be made irrelevant by Canadian National's unconstrained ability to price trackage rights in a way that the replacement railroad could not compete for the business. This is likely to be a particularly serious problem in this instance as the price of trackage rights may be a larger than usual share of the total cost of providing service, forcing the replacement railroad to be very sensitive to the marginal cost of these rights. We have appended relevant portions of the expert testimony of Peter Woodward and Robert Majure in previous railroad merger proceedings (with confidential information redacted) where they discuss this issue in more detail.

III. Conclusion

The Department of Justice opposes unconditional approval of the proposed merger. If the Board determines that the transaction otherwise meets the applicable approval standards, it should adopt appropriate conditions to preserve potential existing build-out opportunities.

Respectfully submitted,

"/s/"
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